Supreme Court of the United States

OCTOBER TERM, 1948.

558

No. 558.

FEDERAL POWER COMMISSION, PETITIONER,

VS.

PANHANDLE EASTERN PIPE LINE COMPANY ET AL.

BRIEF OF RESPONDENT STATE CORPORATION COMMISSION OF THE STATE OF KANSAS.

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OPINIONS BELOW.

The findings of fact, conclusions of law and opinion of the United States District Court for the District of Delaware appear in the record (R. 49-50, 60-66). The opinion of the United States Court of Appeals for the Third Circuit is found in the record (R. 74-81) and is reported at 172 F. 2d 57.

STATUTES INVOLVED.

We note in the Power Commission's Brief that this Court is being furnished pamphlet copies of the Natural Gas Act. We have, therefore, omitted any portion of the Act from the Appendix to this Brief. We have set forth in the Appendix pertinent portions of Chapter 55, Section 7 of the 1947 Supplement to the General Statutes of Kansas, 1935, to which we refer.

SUPPLEMENTAL STATEMENT.

In this Brief, Panhandle Eastern Pipe Line Company will be referred to as Panhandle, Hugoton Production Company as Hugoton, The Federal Power Commission as the Power Commission and the State Corporation Commission of Kansas as the Corporation Commission.

Most of the facts pertinent to this appeal are set out in the "Statement" in the Power Commission's Brief. The Corporation Commission was permitted to intervene in this matter at the Court of Appeals level (R. 74).

The Corporation Commission is empowered and obligated to regulate the production and conservation of natural gas within the State of Kansas (Chapter 55, Article 7, 1947 Supp. to the General Statutes of 1935, Appendix, pp. 17, 18).

Under the authority so conferred, the Corporation Commission has and exercises jurisdiction over the Kansas Hugoton Gas Field. It has issued a Basic Proration Order and each month it issues a monthly proration order regulating the taking of gas from the Field. By so doing it accomplishes the prevention of waste, the protection of correlative rights and the orderly development in and of that common source of supply.

The Corporation Commission is empowered to promulgate such rules and regulations as may be necessary and proper to carry out the spirit and purpose of the statutes (55-704, Appendix, p. 18).

Panhandle produces and purchases natural gas in the Kansas Hugoton Field and its activities there are supervised and regulated by the Corporation Commission.

Several large purchasers of natural gas, among them Panhandle, have sought to obtain large gas reserves within the Hugoton Field by securing gas leases from individual landowners or assignments of leases from individual lessees. Often the reserves secured by a particular purchaser are not advantageously located with respect to the purchaser's transportation facilities, but are near the transportation facilities of another purchaser. Free sale and exchange of leases and production rights among the various purchasers enables them to "block," or consolidate, their respective production acreage near to or around their pipe-line transportation facilities. This practice or activity has been encouraged by the Corporation Commission because it facilitates the operation of the conservation program formulated by the Corporation Commission. It helps to prevent formation of undeveloped islands of productive acreage which is exceedingly important to the Corporation Commission in the discharge of its statutory duty to secure orderly development of the Kansas Hugoton Field (R. 70-74).

The Power Commission asserts that a natural-gas company is obligated to secure the approval of the Power Commission before the company may transfer its reserves. In his argument (R. 46-48), counsel for the Power Commission expresses the view that this obligation holds, regardless of the extent of the intended transfer.

We think such a view translated into Power Commission action will leave the success of the Corporation Commission's efforts to secure orderly development dependent to an unwarranted degree upon the consent of the Power Commission.

QUESTIONS PRESENTED.

1. Has Congress, in the Natural Gas Act, granted to the Federal Power Commission any jurisdiction or control over the transfer by a natural-gas company of undeveloped gas leases?

2. Did the courts below properly refuse the injunction sought by the Federal Power Commission?

ARGUMENT.

I.

The Primary Grant of Power in the Natural Gas Act Does Not Give the Power Commission Jurisdiction Over Transfers of Undeveloped Gas Leases.

The Natural Gas Act (52 Stat. 821, 15 U. S. C. 717-717w) is, at once, Congress' full expression of Federal authority over certain phases of the natural gas industry and the Power Commission's measured mandate to exercise it.

Provisions of the Act (Section 1 (b)) apply to:

(1) the transportation of natural gas in interstate commerce,

(2) the sale in interstate commerce of natural gas for resale, and

(3) natural-gas companies engaged in such transportation or sale.

The Act specifically exempts from the effect of its provisions important activities pertinent to this case to which we will refer later. Presently, we consider only whether the language setting forth the activities to which the Act does apply, in any event, describes or includes the transfers of gas leases on undeveloped acreage. Certainly such transfers are neither "transportation of natural gas in interstate commerce" nor sales "in interstate commerce of natural gas for resale." Does the Act's applicability to "natural-gas companies engaged in such transportation or sale" give the Power Commission jurisdiction over transfers, by a natural gas company, of leased gas reserves?

The act makes no mention of gas reserve transfers and no rule or regulation promulgated by the Power Commission touches this subject.

We will consider now the portions of the Act on which the Power Commission relies as giving it the authority it seeks here to exercise.

A.

Certificate Section Does Not Authorize Control over Reserves.

Section 7 (c) requires the securing of a certificate of convenience and necessity by a natural-gas company, or person which will be a natural-gas company, before it may engage in a transportation or sale of natural gas subject to the jurisdiction of the Power Commission. Section 7 (d) and (e) sets forth how applications shall be made and what must be established to the satisfaction of the Power Commission before a certificate may be granted. The latter paragraph also empowers the Commission to attach to the issuance of a certificate such reasonable terms and conditions as the public convenience and necessity may require.

To obtain a certificate to construct and operate facilities under the jurisdiction of the Power Commission, an applicant must establish its ability to serve. Ability to serve necessarily includes access to adequate reserves. The Power Commission asserts that Panhandle was granted certain certificates on its representations to the Power Commission that, among other things, it had adequate reserves available and the Power Commission contends that those reserves have been thereby dedicated to the public. It says there was an obligation on the part of Panhandle to seek the Power Commission's approval of the transfer. But the Commission's authority under Section 7(c) (d) and (e) extends to granting or refusing a certificate. In exer-

cising that authority, it is concerned with the original determination of gas reserve adequacy only.

We know of no established formula or guide applied by the Power Commission to determine adequacy of reserves. A figure representing "adequate" reserves would, it seems, be a variable, requiring adjustment to changing market demands and transmission capacities. It would not be the same for every company, and for each company it would vary from time to time. The Power Commission does not pretend to compare currently a natural-gas company's reserves to its market demands and require appropriate reductions or additions of productive acreage. The Power Commission has never asserted its approval should be obtained before leases are acquired and not until now that it has power to control transfers. To date, the activity of acquiring or transferring gas leases has been freely and appropriately left to the management of the company, which has a dual obligation to protect the consuming public and the investment in pipe-line facilities. Had the Power Commission in the certificate proceedings determined that maintenance of specific acres of reserves were necessary in the public interest, it could have at least attempted under Section 7 (e) to condition the granting of the certificate on such reserves being maintained.

The Power Commission has full record knowledge of Panhandle's gas reserves and at no point in this proceeding has it contended that the transfer here questioned has rendered those reserves inadequate.

B.

Disposition of Reserves Is Not Abandonment of Facilities or Service.

In its Brief, the Power Commission relies on Section 7 (b) of the Act as providing it with clear authority over

a natural-gas company's disposition of its leased reserves. That subsection reads as follows:

> "(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment."

That reserves are not "facilities subject to the jurisdiction of the Commission" is clear from a reading of the quoted subsection. One of the grounds for abandoning "facilities" or "service rendered by means of such facilities" is inadequacy of reserves. The other ground is that the public convenience and necessity permit such abandonment. Obviously, "facilities" here means the pipe, compressors, meters, etc., between the reserves and the public by means of which the supply of gas is transported and delivered to the public. This is indicated in the argument of counsel for the Power Commission before the District Court below (R. 46).

The Power Commission argues, however, that a gas company may, by disposing of its reserves, disable itself from rendering continued service and thereby effect an abandonment of facilities or service without the Power Commission's approval. If this argument is valid as to reserves, we suppose it might be validly applied if the company decided to discharge some of its employees engaged in operating the facilities and the Power Commission asserted its approval should be first obtained. The argument rests on the fallacious assumption that there

can be no other reserves available to Panhandle if and when it requires additional gas.

In either case, the argument completely overlooks the company's interest in continuing service and the authority of the Power Commission to require continued service. It is no more than an attempt to justify invasion into a field reserved to management and state regulation.

We reiterate that the Power Commission, with full knowledge of Panhandle's system and the extent of its reserves, has not asserted that the transfers here involved will result in or effect the abandonment of any of Panhandle's facilities or service.

C.

Particular Reserves Not Dedicated.

The Power Commission declares control over disposition of reserves is necessary to prevent a natural-gas company from "repudiating the dedication of such gas reserves to the discharge of its obligations as a public utility." Particular reserves are not essential to continued utility operation. Only the extent of available reserves is important. No doubt, Congress' realization of this basic fact led to empowering the Commission (Section 14 (b)) to determine the adequacy of gas reserves held by a natural-gas company. The facts which would be developed in such an investigation of Panhandle (with the possible exception of after acquired leases) have been made known to the Power Commission in FPC Dockets G-706 and G-876 (R. 12-14). Also, the investigating power so conferred has been described as an aid to the Commission in the performance of its rate-making functions, *Colorado Interstate Gas Co.* v. *Federal Power Comm.*, 324 U. S. 581, 602.

It is the position of the Corporation Commission that the dedication is not of particular reserves, but of adequate

reserves, and that a natural-gas company is free to acquire, transfer and exchange reserves subject to legitimate control by the appropriate state agency. Further, that there can be no dedication even of adequate reserves in the Kansas Hugoton Field which transcends the powers of the State of Kansas to limit, stay or divert to other uses the production from that field if the Corporation Commission finds it necessary to do so in the interests of conservation, protection of correlative rights or orderly development in and of the field, *Colorado Interstate case, supra, Interstate Natural Gas Co.* v. *Federal Power Commission*, 331 U. S. 682, 690.

D.

Control of Lease Transfers Not Essential to Rate Making.

Control by the Power Commission over disposition of gas reserves by a natural-gas company is not essential to protect the Power Commission's "rate making function."

The Power Commission's argument on this point (P. C. Brief, I. B. 2(a))[1] is that Panhandle is going to make some unregulated profits on the sale of some of its gas reserves and that this will increase the rates to ultimate consumers. It is not specified whether Panhandle's consumers are meant. It is difficult to see how the transaction here involved will result in increased rates to Panhandle's customers. The increase in book value of the reserves will not affect Panhandle's rate base. This new value will appear on Hugoton's books. Hugoton will sell to Kansas Power and Light Company. If the Power Commission is concerned about the customers of Kansas Power and Light

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[1] Reference to letter designation of topics and subtopics necessary as printed copies of Power Commission's Brief unavailable at this writing.

Company, it wastes its tears. The Corporation Commission in the exercise of its utility regulatory jurisdiction will take care of that matter. Also, the Power Commission need not worry about the price at which Panhandle may purchase from Hugoton fifteen years from now. The broad rate-making powers in the Power Commission confirmed in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. 591, and *Colorado Interstate* case, *supra*, are surely sufficient to solve that affiliate problem for the benefit of the ratepayers. The exercise of these same broad powers after the investigation now pending before the Power Commission, FPC Docket G-1147, will serve to correct any unreasonableness or injustice which may appear in Panhandle's rate structure as a result of the transfer of leases.

In *Panhandle Eastern Pipe Line Co.* v. *Public Service Comm.*, 332 U. S. 507, 521, this Court said:

> "* * * The declaration, though not identical in terms with the one made by the McCarran Act * * * concerning continued state regulation of the insurance business, is in effect equally clear, in view of the Act's historical setting, legislative history and objects, to show intention for the states to continue with regulation where Congress has not expressly taken over * * *."

We submit that nothing in the primary grant of power contained in the Natural Gas Act is an express taking over of regulation of undeveloped gas lease transfers. If the regulation afforded by the Act, the applicable state statutes and the interest of the Company in continuing service is found by experience to be inadequate, further legislation, state or Federal, may be required. It is no justification for the Power Commission to extend the Act beyond its clear applicability that "experience may disclose that it

should have been made more comprehensive," *Addison v. Holly Hill Fruit Products*, 322 U. S. 607, 617.

II.

Transfers of Gas Leases on Undeveloped Acreage Are Activities of Production and Gathering Exempted from the Applicability of the Natural Gas Act.

By Section 1 (b) of the Natural Gas Act, its provisions are made inapplicable to

(1) any transportation or sale of natural gas other than transportation in interstate commerce or sale in interstate commerce for resale,

(2) local distribution of natural gas or to the facilities used for such distribution,

(3) production or gathering of natural gas.

We are concerned only with the exceptions relating to production or gathering. It is established in the decisions of this Court that the exemption goes only to the activity of producing or gathering, *Colorado Interstate* case, *supra*, at page 603, and is to be strictly construed, *Interstate Natural Gas Co. v. Federal Power Comm.*, 331 U. S. 682, 691. It is also clear from these same cases that the activity of production or gathering is excepted from the regulatory jurisdiction of the Power Commission even when such activities are carried on by a natural-gas company otherwise subject to regulation.

In *Colorado Interstate* case, *supra*, at page 603, this Court said, "For example, it (The Act) makes plain that the Commission has no control over the drilling and spacing of wells and the like." These and similar activities are thereby defined as activities of production or gathering. Surely, then, the activity of acquiring or transferring

leases which occurs prior to drilling and spacing is also an activity of production or gathering.

Production of gas is the ultimate objective to be attained in securing a gas lease. The activity of securing and exchanging leases relates only to production and to no other phase of a natural gas company's operations. This activity and its objective, production, is completed before the incidents of Power Commission jurisdiction attach. It is an integral part of the production and falls within the field of regulation left to the states.

The express legislative exception from Power Commission authority over production and gathering cannot be overriden by an "implied obligation" owing its existence solely to administrative zeal.

III.

Exercise by the Power Commission of Jurisdiction over Lease Transfers Will Raise a Conflict Between State and Federal Authority.

The Kansas Hugoton Field is a common source of supply within the meaning of the Kansas statutes relating to conservation of natural gas (See 55-702, Appendix, p. 17). The Corporation Commission has and exercises jurisdiction over production, gathering and marketing of natural gas in the Field.

Free exchange of leases has been encouraged by the Corporation Commission as essential to securing orderly development of the Kansas Hugoton Field (See statement *supra*, pp. 2-3). In its Brief, the Power Commission derides the Corporation Commission's "encouragement" as falling short of a claim or assertion of right to regulate or control the transfer of leases (P. C. Brief, I. B. 1). Perhaps our position was understated. Up to now, "encour-

agement" has been enough to secure the desired result. If encouragement of lease exchanges falls short and such exchanges are necessary to securing orderly development or prevention of waste or protection of correlative rights of and in the common source of supply, appropriate orders implementing the powers conferred by our state legislature (55-702, 55-704, Appendix, pp. 17, 18) will issue.

If and when the exercise of that power in the Corporation Commission becomes necessary, it must not depend for its efficacy on the consent of the Power Commission. Such dependence would raise a conflict between Federal and state authority which this Court has stated Congress meticulously sought to avoid in the Natural Gas Act.

Public Utilities Co. v. *United Fuel Gas Co.*, 317 U. S. 456.

Illinois Nat. Gas Co. v. *Central Ill. Pub. Serv. Co.*, 314 U. S. 498.

Federal Power Comm. v. *Hope Natural Gas Co.*, 320 U. S. 591.

Colorado Interstate Gas Co. v. *Federal Power Comm.*, 331 U. S. 682.

Panhandle Eastern Pipe Line Co. v. *Public Service Comm.*, 332 U. S. 507.

We believe our "deep concern" with the jurisdictional questions involved is justified.

IV.

The Courts Below Properly Refused the Injunction Applied for by the Power Commission.

The Power Commission sought the injunction pursuant to Section 20 (a). That section reads in part as follows:

"Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts

"or practices which constitute or will constitute a violation of the provisions of this Act, or of any rule, regulation, or order thereunder, it may in its discretion bring an action in the proper district court of the United States * * * to enjoin such acts or practices * * *"

In its Brief (P. C. Brief, II, A.), the Power Commission recognizes that its order of November 10, 1948, had to be valid to draw to it the injunctive aid requested. It argues that the order was valid. Our view is and we believe we have demonstrated that a transfer of undeveloped gas leases is beyond the applicability of the Act and, therefore, beyond the Power Commission's jurisdiction. The Power Commission's order of November 10, attempting to control the transfer, is unauthorized by the Act and lacks any validity. Ignoring it cannot constitute violation of the Act or any rule, regulation or order thereunder. An injunction to enforce the invalid order was properly refused.

The Power Commission argues further (P. C. Brief, II, B.) that the District Court below should have granted the injunction in the exercise of its general equity powers. Why the Power Commission requested the exercise of such powers is not clear, unless it desired to avoid the argument as to its jurisdiction. Whatever the reason was, it now asserts, in support of this argument, that it has "jurisdiction over at least some transfers of gas reserves." Were that the case, Section 20 (a) would have been sufficient. Jurisdiction in the Power Commission to issue the order of November 10, 1948, was essential to injunctive assistance to secure its enforcement and that jurisdiction was lacking.

CONCLUSION.

The Power Commission has no authority under the Natural Gas Act to regulate or control the transfer, by a natural-gas company, of undeveloped gas reserves.

The Courts below properly refused the injunction sought and the decision of the Court of Appeals for the Third Circuit should be affirmed.

Respectfully submitted,

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APPENDIX.

Portions of Chapter 55, Article 7 of the 1947 Supplement to the General Statutes of 1935 are set out below:

"55-702. Definitions. That the term 'waste' as herein used, in addition to its ordinary meaning, shall include economic waste, underground waste and surface waste. Economic waste as used in this act, shall mean the use of natural gas in any manner or process except for efficient light, fuel, carbon black manufacturing and repressuring, or for chemical or other processes by which such gas is efficiently converted into a solid or a liquid substance. The term 'common source of supply' wherever used in this act, shall include that portion lying within this state of any gas reservoir lying partly within and partly without this state. The term 'commission' as used herein shall mean the state corporation commission of the state of Kansas, its successors, or such other commission or board as may hereafter be vested with jurisdiction over the subject matter of this act."

"55-703. Production regulations, rules and formulas. That whenever the available production of natural gas from any common source of supply is in excess of the market demands for such gas from such common source of supply, or whenever the market demands for natural gas from any common source of supply can be fulfilled only by the production of natural gas therefrom under conditions constituting waste as herein defined, or whenever the commission finds and determines that the orderly development of, and production of natural gas from, any common source of supply requires the exercise of its jurisdiction, then any person, firm or corporation having the right to produce natural gas therefrom, may produce only such portion of all the natural gas that may be currently

produced without waste. * * * The commission shall so regulate the taking of natural gas from any and all such common sources of supply within this state as to prevent the inequitable or unfair taking from such common source of supply by any person, firm or corporation and to prevent unreasonable discrimination in favor of or against any producer in any such common source of supply. * * *".

"55-703a. Well spacing and orderly development. The drilling and completion of a gas well shall not of itself entitle said well to an allowable for production; and the commission may, in its discretion, provide for well spacing in any such common source of supply and provide for the orderly development thereof."

"55-704. Rules and regulations authorized; notice and hearings. The commission shall promulgate such rules and regulations as may be necessary for the prevention of waste as defined by this act * * * and as the commission may find necessary and proper to carry out the spirit and purpose of this act. * * *";

"55-705a. Certificate required; notice and hearing. Before any gas shall be produced from a well producing gas only, or from a well which is primarily a gas well, for any of the purposes specified in section 2 (55-702) of this act, a certificate shall be obtained from the commission for the construction of the facilities necessary or required and/or the utilization of the gas in the manner and for the purposes intended. * * *"